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IN THE

Supreme Court of the United States

OCTOBER TERM, 1976

No. 75-1771

COMMISSIONER OF INTERNAL REVENUE,
Petitioner

v.

STANDARD LIFE & ACCIDENT INSURANCE COMPANY,
Respondent

On Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

MOTION FOR LEAVE TO FILE BRIEF AMICUS CURIAE, WITH BRIEF ATTACHED

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MOTION FOR LEAVE TO FILE BRIEF AMICUS CURIAE

Amicus Curiae, The Lincoln National Life Insurance Company (hereinafter "Lincoln"), respectfully requests this Court, pursuant to Rule 42(3) of the Rules of this Court, to allow it to file the attached Brief Amicus Curiae in this case. This short Brief is addressed to the question of the deductibility of agents' commissions and state premium taxes on deferred and uncollected premiums (hereinafter sometimes referred to as "the expense deduction issue"). This question is of principal importance to Amicus Curiae, and its interests are not represented adequately by the parties.

Standard Life & Accident Insurance Company (hereinafter "Standard Life") has consented in writ-

ing to the filing of an amicus brief by Lincoln. The United States, however, has refused to consent on the ground (which we believe is erroneous) that there will be no occassion for this Court to address the expense deduction issue.

As reasons for this motion, Lincoln states that it currently has pending in the United States Court of Claims the issue of the deductibility of agents' commissions and state premium taxes on deferred and uncollected premiums. *Lincoln National Life Insurance Company* v. *United States,* Ct. Cl. No. 521-69. On November 12, 1976, Trial Judge Fletcher of the Court of Claims filed his recommended decision and conclusions of law holding, consistent with all courts which have decided the issue, that Lincoln is entitled to deduct agents' commissions and premium taxes on deferred and uncollected premiums in the same year such premiums are taken into income. 38 A.F.T.R.2d 76-6126. The Court of Claims has stayed action on the Trial Judge's opinion on the issue pending this Court's decision in the case here.

The question of the deductibility of agents' commissions and premium taxes on deferred and uncollected premiums arises only if the primary litigating position of the United States as to the includibility of such premiums in the income of Standard Life (*viz.,* that the gross amount of such premiums must be included in income) is accepted by this Court. The United States Court of Appeals for the Tenth Circuit did not reach the expense deduction issue in its decision below since it rejected this position of the United States. Neither the petition for a writ of certiorari nor the Brief filed herein by the United States raises as an issue the deductibility of commissions and premium taxes on deferred and uncollected premiums. However, the Reply of Respondent, Standard Life, to the petition for certiorari (at p. 4, n. 3) called this Court's attention to the line of prior cases, all of which have held that a life insurance company is entitled to such a deduction when the gross amount of such premiums is taken into income, and we understand that the expense deduction issue is in fact involved in this case. Thus, the interest of Lincoln will become direct and substantial if this Court, in deciding the *Standard Life* case, accepts the primary litigating position of the United States that the gross amount of deferred and uncollected premiums is to be taken into the income of a life insurance company and proceeds to a determination of the then ultimate remaining question of the expense deduction for commissions and premium taxes. Since the United States is not addressing this point directly and since we expect that Respondent will address the issue only in summary fashion, a short brief on this point is both appropriate and necessary.

Respectfully submitted,

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BRIEF OF THE LINCOLN NATIONAL LIFE INSURANCE COMPANY, AMICUS CURIAE

INTEREST OF AMICUS CURIAE

Amicus Curiae, The Lincoln National Life Insurance Company (hereinafter "Lincoln"), currently has pending in the United States Court of Claims an action for refund of income taxes paid, in which one issue is whether, under section 809(d)(11) of the Internal Revenue Code,[1] Lincoln may deduct, in computing its taxable income, the amount of agents' commissions and state premium taxes on deferred and uncollected

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[1] Herein, all statutory references are to the Internal Revenue Code of 1954, as amended, unless otherwise indicated.

premiums in the same year that such premiums are taken into account *gross*.[2] (The Commissioner of Internal Revenue, upon audit, included the gross amount of such premiums in Lincoln's income and assets.) *Lincoln National Life Insurance Company* v. *United States,* Ct. Cl. No. 521-69. On November 12, 1976, Trial Judge Fletcher filed his recommended decision and conclusions of law holding, consistent with all courts which have decided the issue, that Lincoln is entitled to that deduction in the same year such premiums are taken into income. 38 A.F.T.R.2d 76-6126. The Court of Claims has stayed action on the Trial Judge's opinion on the issue pending this Court's decision in the case here.

The United States Court of Appeals for the Tenth Circuit did not reach the expense deduction issue in its decision below since it rejected the primary litigation position of the United States, *viz.,* that the gross amount of deferred and uncollected premiums must be included in income. Neither the petition for a writ of certiorari nor the Brief filed herein by the United States raises as an issue the deductibility of agents' commissions and premium taxes on deferred and uncollected premiums. However, the Reply of Respondent to the petition for certiorari (at p. 4, n. 3) called this Court's attention to the line of prior cases, all of which have held that a life insurance company is entitled to such a deduction when the gross amount of such premiums is taken into income, and we understand that the expense deduction issue is in fact involved in this case.

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[2] Hereinafter, for convenience, this issue is sometimes referred to as "the expense deduction issue."

The issue becomes pertinent if this Court determines that *gross* deferred and uncollected premiums are included as "premiums" under section 809(c)(1).[3] Amicus Curiae, Lincoln, addresses itself in this Brief solely to that final issue which, if reached and decided in this case, will affect its interests directly.

The facts in this case have been fully briefed and will not be repeated here.

Respondent, Standard Life & Accident Insurance Company, has consented in writing to the filing of this

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[3] The expense deduction issue emerges as the final element for decision if the gross amount of such premiums, as the Government's consistent primary litigating position and uniform administrative and enforcement position would require, are to be included in both assets and income. The issue becomes equally pertinent if such premiums must be included in income in the gross amount, but in assets only in the amount of the net valuation premiums. This latter determination may be founded upon the pertinent statutes and regulations. It would be consistent, as section 818(a) of the Internal Revenue Code mandates, with the manner required for purposes of the annual statement approved by the National Association of Insurance Commissioners. This determination may be reached by a careful review and consistent application of Treas. Reg. § 1.801-5(b) (annual statement life insurance reserves are "required by law" and include those for policies on which premiums are deferred and uncollected), Treas. Reg. § 1.805-5(a)(4)(i) and particularly Example 1 in subparagraph (ii) (where the absence of specification that deferred and uncollected premiums should be included in assets gross strongly and significantly suggests the inclusion of net valuation premiums, the *only result* "consistent with the manner required for purposes of the annual statement"), Treas. Reg. § 1.809-4(a)(1)(i) (including deferred and uncollected premiums in the definition of "the gross amount of premiums"), and Treas. Reg. § 1.446-1(a)(2) (accounting method reflecting consistent application of generally accepted accounting principles in a particular business in accordance with accepted practices in that business will ordinarily be regarded as clearly reflecting income if all items of gross income and expenses are treated consistently from year to year).

Brief. The United States has refused to consent to the filing of the Brief, and, accordingly, a motion for leave to file the brief pursuant to Rule 42(3) of the Rules of this Court is filed herewith.

ARGUMENT

A LIFE INSURANCE COMPANY IS ENTITLED TO DEDUCT THE ANNUAL INCREASE IN AGENTS' COMMISSIONS AND PREMIUM TAXES ON DEFERRED AND UNCOLLECTED PREMIUMS IN THE SAME YEAR THE GROSS AMOUNT OF SUCH PREMIUMS IS TAKEN INTO ACCOUNT AS INCOME.

A. Introduction

All computations entering into the determination of life insurance company taxable income must be made on an accrual method of accounting or, to the extent permitted under regulations prescribed by the Secretary of the Treasury, under a combination of an accrual method with another permissible method (other than the cash receipts and disbursements method). Section 818(a)(1) and (2).[4]

Premiums are included in a life insurance company's income under section 809(c)(1) as part of the computation of "Gain and Loss from Operations" (as defined in section 809(b)(1) and (2)). A policyholder is not obligated to pay deferred and uncollected premiums. Therefore, a life insurance company would not bring them into income under traditional concepts of accrual accounting. Section 1.446-1(c)(1)(ii) of the Treasury Regulations; *North American Life and Casualty Company* v. *Commissioner*, 533 F.2d 1046 (8th Cir. 1976), *aff'g* 63 T.C. 364 (1974); *Federal Life Insurance Company (Mutual)* v. *United States*, 547 F.2d 1096 (7th Cir. 1975); *Great Commonwealth Life Insurance Co.* v. *United States*, 491 F.2d 109 (5th Cir. 1974); *Midland National Life Insurance Company*, 66 T.C. 550 (1976), appeal filed by taxpayer, 8th Cir., Nov. 15, 1976; *United Life & Accident Insurance Company* v. *United States*, 329 F.Supp. 765 (D.N.H. 1971). However, the Commissioner of Internal Revenue ("the Commissioner"), in reliance upon section 1.809-4(a)(1)(i) of the Treasury Regulations, requires that the gross amount of deferred and uncollected premiums be taken into account as income in the computation of a life insurance company's taxable income. It is the position of Amicus Curiae that, consistently, the annual increase in the "cost of collection" of such deferred and uncollected premiums (*e.g.*, agents' commissions and premium taxes), the payment of which is contingent solely on the collection of such premiums, should be taken into account as a deduction under section 809(d)(11)[5] in the same year that those premiums are taken into income.

There is no question that section 809(d)(11), incorporating the deductions allowed under section 162(a), permits a life insurance company, in computing gain and loss from operations, to deduct *at some time* agents' commissions and premium taxes. Thus, the

[4] Section 818(a) further provides that, except as provided in section 818(a)(1) and (2), all such computations shall be made in a manner consistent with the manner required for purposes of the annual statement approved by the National Association of Insurance Commissioners.

[5] One of the deductions allowed a life insurance company in computing its gain or loss from operations is stated in section 809(d)(11) (section 809(d)(12) prior to P.L. 94-455) as follows:

> "OTHER DEDUCTIONS.—Subject to modifications provided by subsection (e) [not applicable here], all other deductions allowed under this subtitle for purposes of computing taxable income to the extent not allowed as deductions in computing investment yield.

simple issue presented here is one of timing *only*. As Trial Judge Fletcher stated in his recommended decision in the *Lincoln* case: "[T]he question is not 'whether' but 'when'." 38 A.F.T.R. 2d at 76-6130. All courts which have decided the issue have held that the concededly proper deduction for agents' commissions and premium taxes should be allowed in the same year that gross deferred and uncollected premiums are taken into income.

B. The Reported Decisions that Are Precisely in Point Support the Position of Amicus Curiae

It is a well established principle of tax law that, if an item of income is accrued and the only contingency with respect to expenses attributable to such income is collection of the income, such expenses must also be accrued. Consistent with this principle, each of the five courts which has thus far decided the question has held that the expenses of collecting deferred and uncollected premiums are deductible in the year such premiums are reflected in income. *North American Life and Casualty Company* v. *Commissioner, supra; Federal Life Insurance Company (Mutual)* v. *United States, supra; Great Commonwealth Life Insurance Company* v. *United States, supra; Midland National Life Insurance Company, supra; United Life & Accident Insurance Company* v. *United States, supra.* In addition, Trial Judge Fletcher of the United States Court of Claims in his recommended decision and conclusions of law followed the decisions of these courts. *Lincoln National Life Insurance Company* v. *United States*, 38 A.F.T.R. 2d 76-6126 (Ct. Cl. Nov. 12, 1976).

The District Court in New Hampshire, the first court to address the issue in *United Life & Accident Insurance Company* v. *United States, supra*, gave three reasons for permitting a deduction for expenses attributable to the collection of deferred and uncollected premiums in the year such premiums are taken into account in the computation of income. The court first focused on the fact that deferred and uncollected premiums are not accruable under general principles of accrual accounting because a policyholder is not obligated to pay such premiums. The court held that, if the Commissioner of Internal Revenue nevertheless is permitted to require the accrual of deferred and uncollected premiums, the determinable expenses of collecting such premiums similarly must be accrued. The court stated:

> "Once it is assumed that deferred and uncollected premiums have accrued, then the expense portion of those premiums has also of necessity accrued. If collection is assumed for income purposes, then it should be assumed for expense purposes. Consistency requires that the same assumption that is applied to income from deferred and uncollected premiums be applied to the expenses associated with those premiums." 329 F. Supp. at 774.

The second reason advanced by the court was that its decision was consistent with accounting procedures specified in the uniform form of Annual Statement prescribed by the National Association of Insurance Commissioners and required to be filed by a life insurance company. 329 F. Supp. at 774.

Finally, the court pointed to the testimony of the Government's own witness and held that its conclusion was mandated by the necessity for clearly reflecting the income of a life insurance company:

> "The final and most compelling reason is that this deduction will result in a clear reflection of income. An accrual method may comport with generally accepted accounting principles, but at the same time not clearly reflect income. The government's insurance accounting expert testified that to clearly reflect income, an expense deduction should be allowed." 329 F. Supp. at 774 (Emphasis added.)

In *Great Commonwealth Life Insurance Company* v. *United States, supra,* the United States Court of Appeals for the Fifth Circuit held that agents' commissions on deferred and uncollected premiums are deductible in the year such premiums are taken into account in the computation of income.[6] The court began its analysis by noting that since the "all events" test is not satisfied with respect to the expenses of collecting deferred and uncollected premiums,[7] "[t]here is no doubt that the government is entirely correct when it asserts that these agents' commissions are not accruable under generally accepted accounting principles." 491 F.2d at 113. However, the court recognized that the issue does not end at that point, since deferred and uncollected premiums taken into account

[6] The question of the deductibility of premium taxes contingent only on the collection of deferred and uncollected premiums was not raised by the taxpayer in *Great Commonwealth.*

[7] The "all events" test as applied to the deductibility of expenses is described in section 1.461-1(a)(2) of the Treasury Regulations, which provides that "[u]nder an accrual method of accounting, an expense is deductible for the taxable year in which all the events have occurred which determine the fact of the liability and the amount thereof can be determined with reasonable accuracy. . . . [N]o accrual shall be made in any case in which all of the events have not occurred which fix the liability. . . ."

as income by the Comissioner do not themselves satisfy the "all events" test.[8]

The court went on to note that an insurance company's taxable income is distorted when deferred and uncollected premiums, an item as to which there is no right to compel payment, are reflected in gross income. 491 F.2d at 114. In the court's view, the only feasible method of correcting this distortion is to accrue in the same year the commissions on deferred and uncollected premiums. The court said:

> "It would only distort that income yet further not to permit the company to accrue the commission expense deductions, which are only contingent to the same extent that receipt of the premiums themselves is contingent." 491 F.2d at 114.

In *North American Life and Casualty Company, supra,* the United States Tax Court held that the taxpayer was entitled to deduct commissions on deferred and uncollected premiums in the same year such premiums are included in income.[9] The court rejected the Government's contention that the taxpayer was not entitled to accrue deductions for such commissions because they are subject to the contingency of collecting the premiums:

> "This contention, however, ignores the assumption utilized to require accrual of the premium

[8] The "all events" test as applied to the inclusion of income is described in section 1.451-1(a) of the Treasury Regulations, which provides that "[u]nder an accrual method of accounting, income is includible in gross income when all events have occurred which fix the right to receive such income and the amount thereof can be determined with reasonable accuracy."

[9] The question of the deductibility of premium taxes contingent only on the collection of deferred and uncollected premiums was not raised by the taxpayer in *North American Life.*

income. Once the fiction of annual receipt of premiums is accepted, it must be applied for all purposes. Upon receipt of premiums, it is clear that a liability to pay commissions arises. Assumption of receipt of premiums necessarily requires recognition of the concomitant liabilities, for the petitioner cannot receive premiums without incurring corresponding commission expenses. Both the accrual of income and deduction of commissions are subject to the same contingency, that is, the receipt of the premiums. Respondent cannot ignore the contingency in requiring accrual of income yet assert such contingency in determining the accrual of related deductions." 63 T.C. at 373.

The Eighth Circuit, in June 1976, affirmed the decision of the Tax Court in *North American Life.* The Tax Court thereafter followed the *North American Life* decision in *Midland National Life Insurance Company, supra.*

The Seventh Circuit, in *Federal Life Insurance Company (Mutual)* v. *United States, supra,* also sustained the position advanced here by Amicus Curiae. It is particularly noteworthy that the Court of Appeals specifically rejected in that case the Government's contention that its earlier holding in *Franklin Life Ins. Co.* v. *United States,* 399 F.2d 757 (7th Cir. 1968), *cert. denied,* 393 U.S. 1118 (1969), denying a deduction for "loading," precluded a deduction for the expenses in question.

Trial Judge Fletcher of the United States Court of Claims, in his recommended decision and conclusions of law filed in *Lincoln National Life Insurance Co.* v. *United States, supra,* adopted the holdings of these five courts and held that Lincoln is entitled, in computing its gain from operations, to deduct under section 809(d)(11) the increase in agents' commissions and

premium taxes on deferred and uncollected premiums in the same year the gross amount of such premiums is taken into income under section 809(c)(1). In the words of Trial Judge Fletcher:

> "Lincoln's contention is so clearly correct that it has been sustained by every court which has thus far directly considered the question." 38 A.F.T.R. at 76-6129

C. Established Principles of Tax Law Require that Commissions and Premium Taxes on Deferred and Uncollected Premiums Be Taken Into Account in the Same Year Such Premiums Are Reflected in Income

It is a long-standing and established principle that, if an item of income is accrued and the only contingency with respect to expenses attributable to such income is collection of the income, such expenses must also be accrued. The seminal case for this principle is *Warren Co.,* 46 B.T.A. 897 (1942), *aff'd* without discussion of this issue, 135 F.2d 679 (5th Cir. 1943). The case involved a company's liability for commissions payable to its agents when payments were received under conditional sales agreements. The Board of Tax Appeals held, in an opinion acquiesced in by the Internal Revenue Service, 1942-2 C.B. 19, that such commissions were accruable and deductible in the year that the income was accrued, stating:

> "It seems equally clear that petitioner should have the right to accrue against the above mentioned income items its liability to pay the agents' commissions thereon. The contract which petitioner had with its agents definitely provided that the company would pay the agent as his selling commission 'the difference between the selling price and the company's net price.' True, it is that certain portions of this commission were not to be paid to the agent until collections were made

from the customers but the *liability to pay these commissions was just as certain as payment of the notes was certain, no more and no less.* If payment of these notes receivable was sufficiently certain to justify their accrual as gross income, and we have held it was, we think the obligation of petitioner to pay agents' commissions was sufficiently certain to justify their accrual as liabilities." 46 B.T.A. at 913-14 (Emphasis added.)

Also in point are the cases of *Air-Way Electric Appliance Corp.* v. *Guitteau,* 123 F.2d 20 (6th Cir. 1941), and *Ohmer Register Co.* v. *Commissioner,* 131 F.2d 682 (6th Cir. 1942), both holding that reserves for sales agents' commissions are accruable in the year the sales are taken into income, even though the revenue from such sales had not as yet been received. *Accord, Central Cuba Sugar Co.* v. *Commissioner,* 198 F.2d 214 (2d Cir.), *cert. denied,* 344 U.S. 874 (1952). All of the cases cited above were reaffirmed in the recent case of *W.S. Badcock Corp.* v. *Commissioner,* 491 F. 2d 1226 (5th Cir. 1974), and by *Field Enterprises, Inc.* v. *United States,* 348 F.2d 485, (Ct. Cl. 1965), *cert. denied,* 382 U.S. 1009 (1966).

These cases, it is obvious, proceed from the fundamental principle that, in order to reflect income clearly, as required by the Internal Revenue Code, expenses subject to precisely the same contingencies as income and to no other contingencies are to be deducted in the same year the income is taken into account.

Significantly, in discussing this line of cases in *North American Life,* the Tax Court observed:

> "[T]hese cases stand for the proposition that an item of income and its related deductions which are subject to the same fact of contingency should be treated alike for accrual purpose. In the present situation the contingency for accrual of income and deduction of commissions is the same. That is, the contingency for accrual is the collection of the deferred and uncollected premiums. *Having assumed for inclusion purposes that the contingency for collection is subject to the fiction that all premiums have been collected, we cannot treat the deduction of the related expenses on the basis that the fiction of collections did not exist."* 63 T.C. at 374 (Emphasis added.)

CONCLUSION

If taxpayer in the instant case is required under section 809(c)(1) to take the gross amount of deferred and uncollected premiums into account as income in computing its gain from operations, it is entitled to deduct under section 809(d)(11) the annual increase in agents' commissions and state premium taxes on such premiums (and any other determinable related expenses) in the same year such premiums are taken into income. All the cases which have addressed this precise issue have so held and are in total accord with established principles of tax accrual. If this Court reaches the issue, it should affirm those decisions.

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